

Lessors of tangible personal property under true leases in Illinois are deemed end users of the property to be leased and owe Use Tax on their cost price of such property. See 86 Ill. Adm. Code 130.220. (This is a GIL.)

September 14, 2004

Dear Xxxxx:

This letter is in response to your letter dated June 3, 2004, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.ILTAX.com to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

On behalf of our client, Parent and Subsidiary (collectively referred to as "the Companies"), we respectfully request the Illinois Department of Revenue ("the Department") to issue a letter ruling with respect to the following factual situation.

General Information

1. This letter ruling is requested to determine the sales tax consequences of anticipated business practices of the Companies.
2. The Companies are not currently under audit or engaged in litigation with the Department with regard to this issue.
3. The Companies are not aware of any authority contrary to the information referred to and cited below.

Statement of Material Fact

Company Background

Parent manufactures, sells and leases equipment and related supplies (which are necessary to operate the equipment) to its ultimate customers. Parent also provides

maintenance services on behalf of the equipment that it sells and leases to its customers. Due to the competitive pricing within the industry, it is the common practice to bundle as a single charge, the lease payment, maintenance fee and supplies. Parent and its customers also desire a composite invoice for the above-mentioned charges in order to limit transactions between the parties. This invoicing procedure simplifies accounting and record-keeping requirements for both Parent and its customers.

When Parent's customers choose to lease rather than purchase the equipment, Parent's wholly-owned single member LLC Subsidiary is involved in the following two steps:

- (1) Parent sells the equipment to Subsidiary under a sales and service agreement, then
- (2) Parent and Subsidiary enter into a leasing contract with the customer.

The terms of the two contracts mentioned above result in:

- (1) Parent invoicing the customer for the lease payments;
- (2) Parent collecting lease payments from the customer;
- (3) Parent forwarding the lease payments to Subsidiary;
- (4) Customer being responsible for any sales and use tax assessed on the leased equipment during the lease period; and
- (5) Customer making its lease payments with applicable sales tax to the Parent.

For legal purposes, in order to perfect the sale under the Uniform Commercial Code provisions, the parent is required to conduct its leasing activities through its Subsidiary.

Customers who choose to lease the equipment from Subsidiary rather than purchase the equipment from Parent usually purchase the related supplies and maintenance services from Parent. Parent performs all invoice processing for its own sales transactions and also Subsidiary's lease transactions. Parent sends the customer an invoice that includes all charges for lease payments, furnished supplies and maintenance services plus applicable sales tax, in a single bundled amount.

Current Filing Methodology

Parent is registered and collects tax on sales to its Illinois customers. Subsidiary anticipates providing Parent with a resale certificate and leasing the equipment to its customers in Illinois. Subsidiary wishes to be in compliance with Illinois law on taxable transactions within Illinois.

Ruling Request

The Companies respectfully request a nonbinding letter ruling confirming that Parent's and Subsidiary's anticipated filing methodology, which would involve Parent submitting sales tax returns under Parent's FEIN as an agent filer for Subsidiary, is permissible under Illinois law and regulations. Further, if the agency filing request is granted, Companies respectfully request that Subsidiary not be required to register as a business with Illinois, thus not requiring Subsidiary to file zero returns.

Alternatively, the Companies respectfully request a nonbinding letter ruling permitting (1) Parent to collect and remit all sales tax on behalf of Subsidiary for the above

mentioned lease payments under Parent's FEIN number, (2) Subsidiary to register with Illinois and file zero returns and (3) agreement that if Illinois selects either Parent or Subsidiary for audit, both Parent and Subsidiary would be audited and that each would have the right to offset taxes owed and/or paid between each other.

Discussion

Illinois generally requires retailers from outside Illinois making taxable sales of tangible personal property to purchasers within Illinois to register with the Department and to submit sales tax returns with tax to the Department. ILCS Chapter 35 §120/2; ILCS Chapter 35 §120/3; IL Admin. Code 130.701(a); IL Admin. Code 150.901 (a),(c).

We believe the above-mentioned laws, which require a seller to register, submit the sales tax returns and submit tax collected to the Department, were enacted to ensure that Illinois receives its sales tax on a timely and secured basis when sales of tangible personal property are made within the state. We further believe that because Parent and its Subsidiary are involved in a series of co-mingled transactions with common customers, it would be more efficient and effective for both the Companies and the Department of Revenue to administer the sales tax collection, remittance, and filing through a single party.

Conclusion

Based on the facts presented above, we respectfully request that the Department issue a ruling confirming that Parent may submit sales tax returns and collected tax on behalf of the Subsidiary under the Parent's identification number and (1) that Subsidiary not be required to register with Illinois, or, alternatively, (2) that Subsidiary register with Illinois and file zero returns, with an understanding that if either Subsidiary or Parent come under audit, that both would be jointly audited with the right to offset between each other taxes paid and owed to Illinois.

If the Department cannot so conclude or requires additional information, I request that the Department contact me to determine what additional information is required or to allow the taxpayer to rescind the ruling request. We appreciate your response on these issues. Thank you for your consideration of this matter.

We are unable, in the context of a General Information Letter, to issue the ruling you have requested. However, we believe you may find the following information useful in better understanding the liabilities of lessors in Illinois.

For general information purposes please refer to 86 Ill. Adm. Code 130.2010, the Department's regulation that covers the taxation of leases. Under Illinois law, "true leases" and "leases" that are actually conditional sales contracts are treated differently for Retailers' Occupation Tax and Use Tax Purposes. Please note that the State of Illinois taxes leases differently for Retailers' Occupation Tax and Use Tax purposes than the majority of other states. For Illinois sales tax purposes, there are two types of leasing situations: conditional sales and true leases. A conditional sale is usually characterized by a nominal or one dollar purchase at the close of the lease term. Stated otherwise, if lessors are guaranteed at the time of the lease that the leased property will be sold, this transaction is considered to be a conditional sale at the outset of the transaction, thus making all receipts subject to Retailers' Occupation Tax.

A true lease generally has no buy out provision at the close of the lease. If a buy out provision does exist, it must be a fair market value buy out option in order to maintain the character of the true lease. Lessors of tangible personal property under true leases in Illinois are deemed end users of the property to be leased. See 86 Ill. Adm. Code 130.220. As end users of tangible personal property located in Illinois, lessors owe Use Tax on their cost price of such property. The State of Illinois imposes no tax on rental receipts. Consequently, lessees incur no tax liability.

Under Section 130.2010(a), persons who purport to “lease” the use of property, but in fact sell such tangible personal property to nominal “lessees,” are considered to be making conditional sales subject to Retailers' Occupation Tax. Such would be the case when the agreements contain nominal purchase options at the end of the lease term. In these situations Retailers' Occupation Tax is due on all the payments received by the “lessors.” Interest or finance charges may be excluded from gross receipts under installment contracts if the books of the retailers (“lessors”) clearly reflect the amounts of the payments attributable to financing. See 86 Ill. Adm. Code 130.420.

If a “penalty” is added to the base retail price in the event that the purchaser does not pay such price within a specified time and such penalty is paid to the seller, such “penalty” becomes a part of the taxable receipts from the sale. See Ill. Adm. Code 130.420.

As stated above, in the case of a true lease, the lessors of the property being used in Illinois would be the parties with Use Tax Obligations. The lessors would either pay their suppliers, if their suppliers were registered to collect Use Tax, or would self-assess and remit the tax to the Department. If the lessors already paid taxes in another state with respect to the acquisition of the tangible personal property, they would be exempt from Use Tax to the extent of the amount of such tax properly due and paid in such other state. See subsection (a)(3) of 86 Ill. Adm. Code 150.310.

Under Illinois law, lessors may not “pass through” their tax obligation to the lessees as taxes. However, lessors and lessees may make private contractual arrangements for a reimbursement of the tax to be paid by the lessees. If lessors and lessees have made private agreements where lessees agree to reimburse lessors for the amount of the tax paid, then lessees are obligated to fulfill the terms of the private contractual agreements.

The above guidelines are applicable to all true leases of tangible personal property in Illinois except for automobiles leased under terms of one year or less, which are subject to the Automobile Renting Occupation and Use Tax found at 35 ILCS 155/1 et seq. There are also some limited exceptions to the general rule described in the preceding paragraphs. There is an exemption from Retailers' Occupation Tax for sales of tangible personal property to lessors who lease that property to governmental bodies under a lease of one year or longer. See 86 Ill. Adm. Code 130.2012. In addition, the sale of computers and communications equipment and equipment used in the diagnosis, analysis, or treatment of hospital patients is exempt when sold to lessors who lease that property under leases of one year or longer with hospitals to whom the Department has issued a tax exemption identification number. See 86 Ill. Adm. Code 130.2011.

The taxability of maintenance agreements is dependent upon whether the charges for the agreement is included in the selling price of tangible personal property. If the charge for a maintenance agreement is included in the selling price of tangible personal property, that charge is part of the gross receipts of the retail transaction and is subject to Retailers' Occupation Tax liability. No tax is incurred on the maintenance services or parts when the repair or servicing is completed.

If maintenance agreements are sold separately from tangible personal property, the sale of the agreement is not a taxable transaction. However, when maintenance services or parts are provided under the maintenance agreement, the company providing the maintenance or repair will be acting as

a service provider under the Service Occupation Tax Act. The Service Occupation Tax Act provides that when a service provider enters into an agreement to provide maintenance services for a particular piece of equipment for a stated period of time at a predetermined fee, the service provider incurs Use Tax based upon its cost price of tangible personal property transferred to the customer incident to the completion of the maintenance service. See 86 Ill. Adm. Code 140.301(b)(3).

I hope this information is helpful. If you require additional information, please visit our website at www.ILTAX.com or contact the Department's Taxpayer Information Division at (217) 782-3336. If you are not under audit and you wish to obtain a binding PLR regarding your factual situation, please submit a request conforming to the requirements of 2 Ill. Adm. Code 1200.110 (b).

Very truly yours,

Edwin E. Boggess
Associate Counsel

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